

SUBCOMMITTEE NO. 1 on Education



Subcommittee No. 1

Chair, Jack Scott

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ISSUE 1: LAO Proposal: Categorical Funding Reform

DESCRIPTION: The LAO believes that reform of the categorical system would have multiple benefits, including greater transparency, fairness, flexibility, and performance-oriented accountability. To this end, the Legislative Analyst's Office recommends consolidating **\$42 billion** and 43 individual K-12 funding streams into one base funding grant and three categorical block grants. The LAO will present their recommendations to the Subcommittee.

BACKGROUND: The LAO has proposed categorical consolidation since the early 1990's. In their 2008-09 Analysis of the Budget Bill, the LAO again proposes the Legislature consolidate several categorical programs in an effort to increase local flexibility. The LAO has identified the following benefits of categorical reform for LEAs:

- ***Flexibility to Use Funds to Meet Local Priorities.*** Since student and school needs can vary substantially among districts, funding should allow schools and districts the latitude to identify and resolve the most pressing local problems.
- ***Ability to Find Local Solutions to Problems.*** Allowing teachers and administrators to develop solutions to local issues helps build school-site problem-solving capacity and a shared commitment to the improvement process.
- ***Increased Focus on Outcomes.*** The push for greater student success requires adaptation and change at the local level. Increasing local flexibility helps educators to feel safe about trying new things rather than focusing on complying with state rules and regulations.
- ***Increased Understanding of Available Resources and Options.*** Increasing the transparency of the finance system reduces confusion among parents, teachers, and administrators about the level of resources provided by the state and how those funds may be used.

Categorical Programs and Funding: The 2007-08 Budget Act appropriates \$14.9 billion in General Fund support for 62 K-12 categorical programs. These programs fund a broad array of program activities. Among the largest are Special Education (\$3.2 billion); K-3 Class Size Reduction; (\$1.8 billion); Child Development (\$1.8 billion); and Economic Impact Aid (\$994 million).

Many programs, however, are relatively small—30 of the 62 programs received an appropriation of less than \$50 million in the current year. Many of these programs also are comprised of several separate subprograms. The child development program, for example, has eight individual subprograms that serve different subgroups of infants and toddlers using different payment mechanisms. Similarly, the special education program is comprised of more than 15 individual subprograms.

Some Categorical Programs Needed: The LAO notes that some categorical funding, however, may serve legitimate state purposes. In general, categorical funding streams represent a tool used by the state to correct negative local incentives—forces that encourage districts and schools to engage in behavior that is not in the best interests of students. District incentive problems include:

- **Weak Subgroup Accountability.** Local accountability for outcomes may not be sufficiently strong for some subgroups of students. Accountability for foster children, for instance, is weak because (1) there are relatively few foster children in each school and (2) some groups of foster children change placements frequently.
- **Strong District Spending Incentives.** District behavior may be skewed by local factors that favor spending for specific inputs. Categorical programs, for instance, shield state funding from the employee union bargaining process.
- **Lack of Uniformity.** Some state policies require uniform application across the state as a critical condition for program success. The most important example of this is statewide testing, which requires all students in a grade (or subject) take the same test.
- **Cost Shifting.** Local incentives exist for schools and other local governments to shift costs to each other. For instance, failure of county mental health agencies to provide mental health services to students may result in school costs due to a greater number of “problem” students. Similarly, failure to address student academic and social needs can result in higher dropout rates, with the accompanying costs for local government in the form of higher crime and welfare costs.

Overview of LAO Proposal: The LAO recommends the Legislature streamline the K-12 fiscal system by consolidating a large number of categorical programs into one base funding grant and three categorical block grants. Together, these programs total **\$42.3 billion**, reflecting approximately 80 percent of all Proposition 98 K-12 funds.

Figure 1 LAO Proposed K-12 Finance Reform Proposed New Grants	
<i>(In Billions)</i>	
	2007-08 Amounts
Base	\$34.8
Special education	3.2
Opportunity to learn	3.1
Instructional improvement	1.2
Total	\$42.3

Under the LAO proposal, districts would continue to receive the same amount as in the past in the first year. In the future, grants would be equalized based on the formulas contained in each block grant. Also, the underlying requirements of the programs that are merged into the block grants would be eliminated as part of the reform.

Base Funding Grant. The “base” grant is largest of the LAO proposed grants providing almost **\$35 billion**. The new grant would include **existing base revenue apportionments** and **seven other individual funding programs**. The LAO also includes class size reduction (CSR) funds in the base grant. Rather than spread the CSR funds across all grades, however, the LAO recommends the Legislature adopt specific *grade-span* base grants that reflect the higher funding levels for K-3 and 9th grade CSR.

LAO Proposed K-12 Base Grant	
Current Program	2007 - 08 Amounts (In Billions)
Base revenue limits	\$31.4
K-3 Class Size Reduction	1.8
SB 813 incentives	1.4
Meals for Needy Pupils	0.2
9 th Grade Class Size Reduction	0.1
Minimum teacher salary	0.1
Unemployment insurance ¹	-
Public Employees' Retirement System (PERS) reduction	-0.2
TOTAL	\$34.8
¹ Less than \$100 million	

Consolidated Special Education Grant. This grant would merge funding from **seven programs** into the existing per pupil funding formula for special education, creating a **\$3.2 billion** state grant for special education. In identifying the programs to consolidate, the LAO focused on programs that distribute funds to most of the SELPAs or support core special education activities.

While no additional accountability provisions would be recommended, the LAO does recommend the Legislature require the California Department of Education (CDE) to submit an annual performance report on the progress of special education students using data from Standardized Testing and Reporting (STAR) and California High School Exit Examination (CAHSEE).

LAO Consolidated Special Education Grant	
Current Program	2007-08 Amounts (In Millions)
Attendance-based apportionments	\$3,021.5
SELPA* base funding	88.1
Workability	39.6
Vocational Education	5.3
Small SELPA* base funding	2.6
Personnel development	2.5
Low incidence services	1.7
Necessary small SELPA*	0.2
TOTAL	\$3,165.5
*Special Education Local Plan Area	

Opportunity to Learn (OTL) Grant. This grant would merge **11 programs** aimed at students who need additional services to succeed in school. This new grant would provide **\$3.1 billion** in funds to districts and is split into two parts: an academic support grant that would provide compensatory instructional services to disadvantaged students and a student support grant that would fund other types of services or activities that promote learning in schools.

The LAO suggests districts be given flexibility to move money from one grant to the other and also suggest continuing the requirements that districts provide counseling and remedial instruction to students who fail or are likely to fail CAHSEE. Further, the LAO suggests the state monitor district performance under this grant through STAR scoring, graduation rates, and completion of "A through G" courses or an employer-certified vocational certificate. They also recommend the CDE be required to submit an annual performance report on the progress of disadvantaged students using the program data discussed above.

LAO Opportunity to Learn Grant	
<i>Academic Support</i>	
Current Programs	2007-08 Amounts (In Millions)
Targeted Instructional Improvement	\$1,075.7
Economic Impact Aid	994.3
Supplemental Instruction	420.8
CAHSEE Supplemental Instruction	72.8
English Learner Assistance	63.6
Advanced Placement Fee Waivers	3.1
<i>Subtotal</i>	<i>(\$2,630.3)</i>
<i>Student Support</i>	
Grade 7-12 Counseling	\$209.1
School Safety	100.6
Pupil retention	97.5
Community English Tutoring	50.0
AVID (non-98)	9.0
<i>Subtotal</i>	<i>(\$457.2)</i>
TOTAL	\$3,087.5

Expanded School Improvement Grant. Under this last grant, the LAO proposes to merge the funding currently provided by **16 programs** to provide **\$1.2 billion** for the new grant. The new grant is comprised of two parts, one targeted at instructional improvement and the second focused on staff development. Consistent with the purposes of the other grants, this grant would free districts from the specifics of the existing grants but would still require districts to use the funds to improve student achievement through better instructional approaches and training.

The LAO proposes distributing funding for the two grants based on average daily attendance and allowing districts to transfer funds between the grants. They would not provide additional accountability as they feel that school accountability under existing state and federal law is sufficient.

LAO School Improvement Grant	
<i>Instructional Improvement</i>	
Current Programs	2007-08 Amounts (In Millions)
School & Library Improvement Grant	\$465.5
Arts and Music Grant	109.8
Gifted and Talented	51.3
Partnership Academies	23.5
Education Technology	17.7
Specialized Secondary Program	6.2
Civic Education	0.3
<i>Subtotal</i>	<i>(\$674.3)</i>
<i>Staff Development</i>	
Professional Development	\$274.7
Teacher Credentialing Block Grant	128.7
Mathematics and Reading Professional Development Program	56.7
Staff Development	32.7
Alternative Certification (Intern)	31.7
Certificated Staff Mentoring	11.7
Paraprofessional Teacher Training	7.9
Teacher Incentives National Board	6.0
Principal Training	5.0
<i>Subtotal</i>	<i>(\$555.1)</i>
TOTAL	\$1,229.4

RELATED LEGISLATION:

SB 1755 (Romero) – Categorical Reform. States intent of the Legislature to enact legislation that would streamline the funding for categorical education programs for kindergarten and grades 1 to 12, inclusive.

AB 599 (Mullin) – Revenue Limit Consolidation. Consolidates revenue limit apportionments with four revenue limit add-on programs.

AB 2831 (Fuller) – Categorical Reform. Authorizes a school district or county office of education to transfer any and all of the unencumbered available balance of state categorical program funding to the general fund of that district or office for encumbrance and expenditure, for any appropriate purpose determined by its governing body, except for the expansion of existing programs or for increasing the salaries of that agency's personnel for the 2008-09 and 2009-10 fiscal years. This provision would prohibit the transfer of the unencumbered available balance of the capital outlay funds, federal funds, proceeds of bonds issued by that agency, or sinking funds for the repayment of funds borrowed through the issuance of bonds by that agency. This provision would become inoperative on July 2, 2013, and would be repealed on January 1, 2014.

AB 2933 (Committee on Education) – Categorical Reform. Requires the Superintendent of Public Instruction to provide an analysis to the Legislature based on information for each state and federal categorical program annually compiled and updated by the department pursuant to existing law. The bill would require this analysis to be submitted to the Legislature by January 15, 2010, and to include, but not necessarily be limited to, a summary by program and object of the expenditure of funds provided to school districts through each of the block grants created, under a prescribed statute, for the funding of categorical education programs.

ISSUE 2: Local Funding Flexibility: Governor's Proposal To Expand Local Transfer Authority per Budget Control Section 12.40

DESCRIPTION: The Governor proposes to expand the authority of local educational agencies (LEAs) to transfer funds among a selected list of categorical programs. Budget Control Section 12.40 currently allows LEAs to transfer up to 10 percent of the funds allocated for a list of 12 programs into other programs on the list, as long as the total increase to any one program does not exceed 15 percent of the base of the receiving program. The Governor proposes to allow LEAs to move up to 50 percent of the funding for these categoricals into other programs on the list, as long as the total increase does not exceed 55 percent of the funding for any program.

BACKGROUND

Control Section 12.40 of the budget gives local educational agencies – school districts and county offices of education -- additional budget flexibility by allowing them to shift limited amounts of funding among categorical programs. This control section was added to the 1999-2000 budget to retain some of the transfer authority among categorical programs included in a budget “mega-item” for categorical appropriations that was eliminated that year.

The original control section allowed transfer of up to 20 percent of funding out of any program and transfer of up to 25 percent into any other program listed in the Control Section. This transfer authority was reduced to up to 10 percent “out” and 15 percent “into” beginning in 2003-04 as the result of the significant, limited-term budget flexibility options authorized for LEAs that year. (Other flexibility options are in the following agenda item.) Transfer authority has remained at 2003-04 levels ever since.

However, while the 2003-04 Budget Act reduced transfer authority levels for LEAs, subsequent legislation contained in AB 1266 (Chapter 573; Statutes of 2003) amended the budget to allow LEAs to transfer up to the amounts they transferred in 2002-03 per the Control Section 12.40. Reportedly, AB 1266 also gave LEAs the ability to mix transfers more than allowed by the Control Section. The authority provided by AB 1266 was in effect for the 2003-04 fiscal year only, reflecting legislative intent, and was not continued in Control Section 12.40 in 2004-05.

Control Section 12.40, as first enacted, provided transfer authority for 25 categorical programs that were previously contained in the budget mega-item; the 2007-08 budget covers just 12 programs. The list of programs covered by the control section has been reduced in recent years, to reflect programs that were eliminated or consolidated into other programs. For example, programs consolidated into block grants pursuant to AB 825 (Chapter 871; Statutes of 2004) were removed from the list of covered programs.

Additionally, the 2006-07 Budget Act removed two programs -- Economic Impact Aid and Foster Youth Services – from the list of programs LEAs could transfer funds “out” of, but retained the ability of LEAs to transfer other categorical programs “into” these programs.

Governor’s Budget Proposal: The Governor proposes to increase the transfer authority in Control Section 12.40 from up to 10 percent out to up to 50 percent out; and from up to 15 percent into to 55 percent into covered programs. These changes are proposed as a means of providing LEAs with greater funding flexibility to offset the Governor’s proposed budget reductions. The Governor’s 2008-09 budget proposes no changes to the number of programs covered by Control Section 12.40, which includes the following 12 programs covered in the 2007-08 budget. Together these programs total nearly \$2.1 billion.

Programs Covered by Control Section 12.40	Program Appropriation -- 2008-09 Proposed
Economic Impact Aid*	\$1,043,396,000
Home-to-School Transportation	660,882,000
Child Nutrition	130,420,000
Year-Round School Grants	101,595,000
Gifted and Talented Education	58,084,000
Staff Development	34,092,000
Foster Youth Services*	19,828,000
Educational Technology Programs	18,485,000
Specialized Secondary Programs	6,427,000
Agricultural Career Tech. Education Incentive Program	5,430,000
American Indian Education Centers	695,000
Teacher Dismissal	50,000
<i>*Funds can be transferred into, not out of these programs.</i>	

CDE Transfer Report: As a condition of receiving the funds provided for the programs covered by Control Section 12.40, LEAs must report annually (by October 1st) to the California Department of Education (CDE) on the amounts they shift between programs. CDE is required to report this information by February 1st of each year to the Joint Legislative Budget Committee, the chair and vice-chair of the fiscal committees of each house of the Legislature, and the Department of Finance.

The most recent transfer report available from CDE is for 2004-05, when there were a larger number of programs in the control section. Several of these programs are no longer listed in the control section because they were rolled into the block grants as a part of AB 825 in 2004.

CDE has provided some raw data on Control Section 12.40 transfers for 2005-06, but has not yet summarized this information to reflect net transfers out and into programs at the state level. CDE is working to finalize this information. CDE is also currently preparing the 2006-07 transfer required by the Control Section, which was due February 1, 2008.

COMMENTS:

Correction to Amount Proposed. The Governor's proposed budget bill increases the transfer authority in Control Section 12.40 to up to 60 percent out and up to 65 percent into covered programs. The Department of Finance reports that this is an error and the Governor's official proposal requests an increase of up to 50 percent out and up to 55 percent into covered programs.

Timeframe for Control Section Transfer Uncertain. The Governor's proposal is intended to offset proposed reductions to the K-12 education budget in 2008-09. It is unclear if changes to the Control Section are intended to be temporary (one-year only, limited-term) or permanent.

Programs in Control Section Subject to Governor's Reductions. The Governor has proposed across-the-board reductions for all 12 programs covered by Control Section 12.40. Access to transfer authority could be useful for mitigating reductions for some of these programs.

CDE Reports Overdue. Staff recommends that the Subcommittee urge CDE to provide the annual report describing categorical transfers by LEAs authorized by Control Section 12.40. This information would be helpful for the Subcommittee in evaluating existing transfer authority and the Governor's expansion proposal.

Utilization Levels Unclear – Fewer Programs; Less Funding Available for Transfer. While LEAs appear to support transfer flexibility provided by Control Section 12.40, it is not clear how LEAs utilize these provisions. The number of programs covered has declined from 25 to 12 since the Control Section was created. The most recent CDE report available, which reflects transfers for 2004-05, indicates that overall, most of the transfers involve two large categorical programs. Specifically, Economic Impact Aid (EIA) accounted for most of the funding transferred out of programs. Home-to-School transportation was the program that received the greatest amount of transfers into programs. However, EIA is now protected from transfers "out", which reduces the total amount available for transfer.

Transfer Authority Obscures Alignment of Funding with Programs Needs. Under the Governor's proposal, LEAs would have the authority to move up to 50 percent of funds out of some programs and increase funding into other programs by up to 55 percent. If transfers of this magnitude are available, it may be the case that programs can be reduced or eliminated and savings can be captured by the state. If so, state savings could mitigate the level of statewide program reductions that may be required for K-12 schools. For example, the LAO has recommended phasing out the Year Round Schools programs, starting with savings of \$19 million a year in 2008-09. Maybe this is a better approach than allowing LEAs to shift funds for this program to other programs.

Is Expansion of the Control Section Useful? The Governor's proposal would provide fairly extensive authority for fund transfers for a small number of programs. Historically,

most funds were shifted from EIA to Home-to-School Transportation. With the exclusion of EIA, most funding available for transfer would come from Home-to-School Transportation, Child Nutrition, Gifted and Talented Education, Year Round Education, and Staff Development. Home-to-School Transportation has been a big user of Control Section transfers due to excess costs of running these programs at the local level. According to CDE, there are significant restrictions for LEAs in reducing state child nutrition funds due to federal maintenance of effort requirements. Also, funds can only be transferred to other programs covered by the Control Section. Maybe less authority among a larger group of programs would provide more relief to LEAs in mitigating program reductions. There may be more appropriate and effective flexibility options for providing more relief to LEAs.

Other Budget Control Sections – Supplemental Instruction Flexibility. Budget Control Section 12.65 was added to the 2002-03 budget to allow the State Controller, upon request of the Superintendent of Public Instruction and approval of the Director of Finance, to transfer unencumbered funds among four Supplemental Instruction programs (before, after, and summer school programs). This Control Section was added as a part of SB 18X (Chapter 4; Statutes of 2003). Control Section 12.65 provides flexibility for state appropriations. The intent of this section is to ensure that supplemental instruction and remedial programs are funded at statutorily authorized levels.

ISSUE 3: Local Funding Flexibility: Other Options

DESCRIPTION: The Legislature authorized a number of different funding flexibility options for local educational agencies (LEAs) in 2003 to mitigate significant budget reductions to the 2002-03 and 2003-04 budgets. These options were offered in order to help LEAs maintain programs in the face of budget cutbacks by giving them some flexibility to direct funds to where they were most needed. Most of these options were authorized by SB 18X (Chapter 4; Statutes of 2003) -- enacted in March 2003 as a part of the mid-year cuts to the 2002-03 budget -- and by AB 1754 (Chapter 227; Statutes of 2003) -- the 2003-04 education budget trailer bill enacted in August 2003. These flexibility options are described below.

Reserve for Fiscal Uncertainty

Current Law: Existing law requires school districts to maintain specific minimum funding reserves for economic uncertainty, as previously adopted by the State Board of Education. Reserve requirements range from one percent to five percent of district general purpose funding, depending on district size. (One percent for the largest; five percent for smallest districts.)

Flexibility Provided: SB 18X reduced the standards for minimum reserves established for economic uncertainty for school districts to one-half of their required levels for the 2002-03 fiscal year. Freed up funds could be used for any purposes determined by the school districts governing board. SB 18X included legislative intent language that school districts use the flexibility provided to address mid-year budget reductions for the Peer Assistance and Review Program; Supplemental Instruction and Remedial Programs; and one-time funding for the Instructional Materials Realignment Program. Additional intent language stated that LEAs make every effort to maintain prudent expenditure plans that ensure fiscal solvency in 2002-03 and subsequent fiscal years.

AB 1754 extended this reserve authority for two more years. Specifically, AB 1754 reduced minimum reserve requirements for economic uncertainty to one-half of the percentage for the reserve minimums adopted by the State Board of Education as of May 1, 2003. Reserves were lowered for both the 2003-04 and 2004-05 fiscal years and restored to the percentages adopted by the State Board of Education on May 1, 2003 in 2005-06.

Flexibility Authority: SB 18X (Chapter 4; Statutes of 2003); AB 1754 (Chapter 227; Statutes of 2003).

Comments: The Department of Education has a number of concerns about the risks associated with reducing LEA minimum reserves for economic uncertainty, given the state's current budget shortfall and the Governor's proposed reductions for K-12 education. Most importantly, CDE points out that reserves are necessary for managing fiscal uncertainty and reducing the reserve requirements could increase the risk of fiscal

insolvency, requiring state emergency funding and interventions. Fortunately, CDE notes that very few school districts utilized the option of lowering their minimum reserves for economic uncertainty, especially since minimum reserves needed to be restored in 2005-06.

Access to Restricted Fund Balances

Current Law: Existing laws generally prohibit LEAs from transferring funds from restricted program accounts to other general or categorical program purposes, without specific budget or statutory authority.

Flexibility Provided: In order to mitigate budget reductions in 2002-03 and 2003-04, LEAs were given specific authority to access the account balances for restricted program funds – categorical programs -- and use them for general purposes. However, the rules governing local use of these restricted account balances were different in each of these years.

In 2002-03, SB 18X gave LEAs access to up to 50 percent of its restricted General Fund accounts, as of July, 1, 2002, for the 2002-03 fiscal year. LEAs were prohibited from accessing reserves committed for capital outlay, bond funds, sinking funds, and federal funds. LEAs were not prohibited from accessing reserves from any categorical programs.

LEAs were also allowed to access up to 50 percent of their reserves for economic uncertainty. However, LEAs access to reserves for economic uncertainty and restricted account balances could not exceed the level of LEA budget reductions in 2002-03.

SB 18X included legislative intent that access to reserves for economic uncertainty and restricted account balances be used to address budget reductions for the Peer Assistance and Review Program; Supplemental Instruction and Remedial Programs; Instructional Materials Funds.

AB 1754 continued LEA access to restricted account balances for the 2003-04 fiscal year; however, the rules governing this access changes. Specifically, LEAs were allowed to use 100 percent of their general fund and cafeteria restricted balances as of June 30, 2003, to offset revenue limit reductions LEAs were not allowed to access capital outlay funds, sinking funds or federal funds, as in SB 18X.

AB 1754 prohibited LEAs from accessing account balances from the following five categorical programs:

- Public Schools Accountability Act (II/USP & HP)
- Economic Impact Aid
- Targeted Instructional Improvement Grants
- Instructional Materials
- Special Education

In addition, LEAs could not access funds available at the end of the year due to program deferrals and funds required to maintain federal maintenance of effort requirements. If LEAs accessed funds available for reimbursement of mandate claims; they could not submit a claim for subsequent reimbursement.

AB 1754 stated that LEAs may use freed up funds from restricted account balances, reserves for economic uncertainty and routine maintenance authorized in 2003-04, to backfill their share of the revenue limit reduction in 2003-04. Revenue limits were reduced by 1.2 percent or \$350 million in 2003-04.

A memo from the Superintendent of Public Instruction (SPI) to LEAs in November 2003 stated that these freed up funds could be used to mitigate the impact of 2003-04 budget reductions, not just revenue limit reductions. That same memo defined available restricted balances as total restricted accounts available on June 30, 2003, minus any accounts excluded by AB 1754 and those balances that LEAs have determined would be better spent in the original program based upon local priorities.

AB 1754 requires LEAs that elect to use restricted account balances to report the programs and amounts to the SPI, in a manner determined by the SPI. In turn, the SPI is required to report this information to the Joint Legislative Budget Committee in a timely manner. The California Department of Education (CDE) recently provided transfer data contained in this report; a copy of the full report is forthcoming.

Flexibility Authority: SB 18X (Chapter 4; Statutes of 2003); AB 1754 (Chapter 227; Statutes of 2003).

Comments: Both SB 18X and AB 1754 contained language attempting to tie LEA access to restricted account balances to the level of LEA budget reductions. However, these provisions were not clearly defined for implementation and enforcement purposes. CDE did gather data on AB 1754 transfers in 2003-04. Statewide, LEAs transferred \$223 million into general purpose accounts. The largest account transfers out include the following:

- Unrestricted (\$35.4 million)
- English Language and Intensive Literacy Program (\$26.8 million)
- English Language Acquisition Program (\$25.4 million)
- Teachers as a Priority Program (\$19.5 million)
- School Improvement Program (\$16.3 million)
- California Public School Library Act (\$10.5 million)
- Peer Assistance and Review Program (\$9.5 million)
- School Violence & Safety Prevention (\$8.9 million)
- School Improvement & Pupil Achievement Block Grant (\$8.6 million)
- School Based Coordination Program (\$6.9 million)
- Community Day Schools (\$6.2 million)
- Gifted and Talented Education (\$5.0 million)

Routine Maintenance Reserve

Current Law: Under current law, school districts that receive state bond funds are required to establish a restricted account within the school district's general fund for the purpose of providing money for ongoing and major maintenance of school buildings. State law requires school districts deposit at least three percent of general fund expenditures of the school district for that fiscal year in the account.

The routine maintenance reserve requirement was added to the state building program in 1998 in order to encourage school districts to maintain state investments in school facilities.

School districts are authorized to use 0.5 percent of their routine maintenance reserves to satisfy its required match for state Deferred Maintenance program funds. Remaining reserve funds are utilized for routine and major maintenance generally performed by district classified staff.

Flexibility Provided: Pursuant to AB 1754 in 2003, school district maintenance reserves were reduced from three to two percent of general fund expenditures. This authority was provided for 2003-04 fiscal year only.

Flexibility Authority: AB 1754 (Chapter 227; Statutes of 2003)

Related Legislation. AB 2832 (Fuller) -- Routine Maintenance Reserve. For the 2008–09 and 2009–10 fiscal years, this bill would authorize school districts to deposit a minimum amount equal to or greater than 1.5% of the total general fund expenditures of the school district for those respective fiscal years. The bill would prohibit funds diverted to another purpose under this bill from being expended or encumbered for the expansion of existing programs or for increasing the salaries of a school district's personnel.

Comments: Lowering the routine maintenance reserve from three to two percent could free up one percent of general purpose funding for other purposes in school districts. Lower funding will reduce maintenance services in school districts, making it more difficult for schools to maintain clean and safe school environments.

Deferred Maintenance Local Match

Current Law: The Deferred Maintenance Program, as administered by the Office of Public School Construction (OPSC), Department of General Services, provides funding for school facilities maintenance.

This program provides state matching funds to school districts to cover major repairs or replacement of school facilities generally to ensure a clean and safe educational environment for students. Maintenance projects typically include roofing, plumbing,

heating, air conditioning, electrical systems, wall systems, floor systems, inspection and removal of asbestos and lead, etc.

The Deferred Maintenance Program provides two types of state grants to school districts. The Basic Grant is provided to districts for the major repair or replacement work listed on the *Five Year Plan*, which is a projection of deferred maintenance work to be performed within the district over the next five years. The Extreme Hardship Grant is provided in addition to the Basic Grant if the district has a critical project on the five year plan that must be completed within one year due to health and safety or structural reasons.

Funding for the Deferred Maintenance Program is provided largely through the budget act, although funding is also provided by excess repayments from the State School Building Aid Program and from State School Site Utilization Funds.

Senate Bill 892 (Chapter 909; Statutes 2004) addresses sufficiency and availability of restroom facilities in public schools. The OPSC has established procedures for concerned parties to file complaints regarding the condition of public school restrooms. Failure to address the violation outlined in the complaint may result in the withholding of the district's Deferred Maintenance Basic Grant apportionment.

Flexibility Provided: Education Code section 17584 requires the State Allocation Board to apportion state funds from the Deferred Maintenance Program to school districts on a dollar-for-dollar basis up to 0.5 percent of general fund expenditures. SB 18X waived the local education agency match requirement for participation in the Deferred Maintenance Program for the 2002-03 fiscal year. Later, AB 1754 eliminated the match requirement for the 2003-04 fiscal year.

Flexibility Authority: SB 18X (Chapter 4; Statutes of 2003); AB 1754 (Chapter 227; Statutes of 2003).

Comments: Waiver of the local match requirement for the Deferred Maintenance program could free up the equivalent of 0.5 percent of the district's general fund expenditures for other purposes. However less funding for deferred maintenance will delay scheduled repair or replacement projects and could contribute to higher costs and health and safety problems. Reportedly, deferred maintenance projects typically involve contract services rather than district employees.

Instructional Materials – Extend Purchase Period

Current Law: Current law requires that every K-8 pupil be provided with state-adopted instructional materials aligned to state standards by the start of the school term that commences no later than 24 months from the state adoption date for K-8 materials. The current state standards-aligned K-8 instructional materials adoptions are as follows:

2005 - History-Social Science

2006 - Science

2007 - Mathematics

2008 - Reading/Language Arts/English Language Development

State law established pursuant to the Williams settlement agreement requires that every K-12 pupil be provided with appropriate standards-aligned instructional materials by the end of the second month of each school year. The Williams settlement does not specifically require that the textbooks be state adopted, in contrast to the state Instructional Materials Program; however, the Williams settlement requires standards-aligned textbooks or instructional materials in the same four core curriculum areas as the state Instructional Materials Program.

The 2007-08 budget appropriates \$420 million for the state Instructional Materials Program, which provides \$69.32 per K-12 pupil. An LEA that does not provide each student with the newly adopted instructional materials within the 24 months risks loss of Instructional Materials funding.

Flexibility Provided: Following mid-year reductions for instructional materials in 2002-03, SB 18X allowed LEAs to utilize previously adopted instructional materials in 2002-03 and 2003-04, instead of purchasing newly adopted materials within the 24 month time period. In effect, SB 18X allowed LEAs to delay the purchase of new Reading/Language Arts materials that were adopted by the State Board in 2002. Following additional reductions in the 2003-04 budget, AB 1266 extended the timeframe for providing newly adopted instructional materials to K-8 pupils from 24 months to 36 months and made that change effective through the 2004-05 fiscal year.

Flexibility Authority: SB 18X (Chapter 4; Statutes of 2003); AB 1266 (Chapter 573; Statutes of 2003)

Comments: Under the current adoption cycle, LEAs must provide the new, state adopted science instructional materials to each K-8 pupil in 2008; new math materials must be provided in 2009; and new Reading/Language Arts materials must be provided in 2010. The benefit to LEAs of extending the 24 month timeframe for purchase of newly adopted materials would be to avoid costly purchases and save funds for future purchases. In this case, Instructional Materials funds would accumulate large year-end account balances that could be tapped if LEAs have access to restricted ending balances. However, LEAs were not allowed access to ending balances for Instructional Materials by any of the previously enacted flexibility options.

K-3 Class Size Reduction

Current Law: School districts participating in the existing Class Size Reduction (CSR) program are eligible to receive an apportionment of \$1,071 per pupil in a kindergarten, first, second, or third grade class if the class maintains an average size of 20 or fewer pupils per teachers.

Current law, established by SB 311 (Sher) – Chapter 910; Statutes of 2004) provides for mitigation of penalties for participating school districts that fail to maintain class sizes at these specified levels. These penalties will sunset on July 1, 2009.

Under current statute, once mitigation penalties sunset, pre-existing statute will take effect. Under the pre-existing statute, participating school districts would lose all of their K-3 CSR apportionments if average class sizes exceed 20 pupils.

Flexibility Provided: Mitigation of K-3 CSR penalties were considered as a part of the special session convened to address mid-year budget adjustments to the 2002-03 budget in early 2003. SB 10X (Sher) , as passed by the Senate, created a new CSR Flexibility Alternative program, in addition to the existing CSR program, that schools could elect to participate in if they had hired “fully and properly credentialed” teachers. Previously, schools lost all K-3 CSR funding if they exceeded an average of 20 pupils. (SB 10X did not pass the Legislature; a similar measure, SB 311 (Sher), was enacted in 2004.)

Flexibility Authority: Education Code Section 52124.

Related Legislation: SB 1112 (Scott) -- Class Size Reduction. Extends current law -- which sunsets July 1, 2009 -- to allow school districts to exceed the 20:1 pupil-teacher ratio and continue to receive partial funding for the state grade K-3 class size reduction program.

Comments: There will be additional costs to LEAs if the CSR flexibility provided in current law sunsets on July 1, 2009. However, if LEAs can no longer afford to participate in the CSR program, districts may drop out of this voluntary program and there will be additional savings for the state.

Reallocation of Supplemental Grants

Current Law: The Supplemental Grants was created in 1989-90 to equalize categorical aid to LEAs. In October 1995, LEAs were required to designate revenue limit and categorical programs that would receive the grant.

Flexibility Provided: In 2003 school districts were allowed to change the categorical programs they designate to fund with state Supplemental Grants. Districts were required to report these changes to the Superintendent of Public Instruction – in December 2003 -- on a one-time only basis.

Flexibility Authority: AB 1266 (Chapter 573; Statutes of 2003).

Comments: The Supplemental Grant program, previously authorized in statute, was folded into the Targeted Instructional Improvement Block Grant following enactment of AB 825 in 2004.

ISSUE 4: Fiscal Status of School Districts –FCMAT Presentation

DESCRIPTION: Joel Montero, Chief Executive Officer, Fiscal Crisis & Management Assistance Team (FCMAT), will provide a presentation on the financial status of school districts and county offices of education, including an update on the number of districts with negative certifications on the latest Financial Status Report.

BACKGROUND:

Interim Financial Status Reports. Current law requires local educational agencies (LEAs) -- school districts and county offices of education -- to file two interim reports annually on their financial status with the California Department of Education. First Interim Reports are due to the state by January 15 of each fiscal year; Second Interim reports are due by April 15 each year. Additional time is needed by the Department to certify these reports.

As a part of these reports, LEAs must certify whether they are able to meet their financial obligations. The certifications are classified as positive, qualified, or negative. A positive certification indicates that a LEA will meet its financial obligations for the current and two subsequent fiscal years; whereas a qualified certification indicates a LEA may not meet its financial obligations during this period. Under a negative certification, LEAs are unable to meet their financial obligations in the current year or in the subsequent fiscal year.

According to the First Interim Report for 2007-08 – the most recent report available – there are currently 7 school districts with negative certifications and 27 school districts and 1 county office of education with qualified certifications. In contrast, the First Interim Report for 2006-07 included 3 districts on the negative list and 19 districts on the qualified certification list.

Attachment A provides a complete listing of negative and qualified certifications. The 7 school districts with negative certifications listed below will not be able to meet their financial obligations for 2007-08 or 2008-2009.

District	County	Budget (\$)
Vallejo City Unified	Solano	152.7 million
Chico Unified	Butte	116.8 million
Dixon Unified	Solano	31.4 million
Healdsburg Unified	Sonoma	20.7 million
King City Joint Union High	Monterey	20.3 million
Aromas-San Juan Unified	San Benito	12.8 million
Gorman Joint Elementary	Los Angeles	1.1 million

Only one school district on the negative list for the First Interim Report in 2007-08 -- Vallejo City Unified – was also on the negative list for the First Interim Report in 2006-

07. Regarding the other two districts on the 2006-07 negative list – Biggs Unified is on the qualified list and Parlier Unified is now on the positive list for 2007-08.

According to FCMAT, the number of school districts with negative and qualified certifications will probably increase when the Second Interim Report for 2006-07 is released by CDE in June or July.

State Emergency Loan Recipients. A school district governing board may request an emergency apportionment loan from the state if the board has determined the district has insufficient funds to meet its current fiscal obligations. Current law states intent that emergency apportionment loans be appropriated through legislation, not through the budget. The conditions for accepting loans are specified in statute, depending on the size of the loan.

For loans that exceed 200 percent of the district's recommended reserve, the following conditions apply:

- The State Superintendent of Public Instruction (SSPI) shall assume all the legal rights, duties, and powers of the governing board of the district.
- The SSPI shall appoint an administrator to act on behalf of the SSPI.
- The school district governing board shall be advisory only and report to the state administrator.
- The authority of the SSPI and state administrator shall continue until certain conditions are met. At that time, the SSPI shall appoint a trustee to replace the administrator.

For loans equal to or less than 200 percent of the district's recommended reserve, the following conditions apply:

- The SSPI shall appoint a trustee to monitor and review the operation of the district.
- The school district governing board shall retain governing authority, but the trustee shall have the authority to stay and rescind any action of the local district governing board that, in the judgment of the trustee, may affect the financial condition of the district
- The authority of the SSPI and the state-appointed trustee shall continue until the loan has been repaid, the district has adequate fiscal systems and controls in place, and the SSPI has determined that the district's future compliance with the fiscal plan approved for the district is probable.

Five school districts are currently receiving state emergency loans – Emery Unified, Oakland Unified, Richmond/West Contra Costa Unified, Vallejo Unified, and West Fresno Elementary. Attachment B summarizes the amounts of these emergency loans and the status of repayments. Two other districts – Compton Unified and Coachella

Valley – have received emergency loans from the state since 1991, but have paid off those loans.

Of the five districts with continuing emergency loans from the state, Vallejo Unified remains on the negative list in 2007-08 and Oakland Unified remains on the qualified list for the First Interim Report in 2007-08. The other three districts -- West Fresno Unified, West Contra Costa Unified, and Emery Unified -- are not on either the negative or qualified certification lists for the First Interim Report.

Annual Reports for Districts Receiving Emergency Loans. Legislation appropriating emergency state loans to school districts requires the preparation of annual written status reports for assessing the progress of schools districts in meeting their improvement plans. These reports are prepared by FCMAT for a three year period through funds provided in emergency loan legislation for each district. There is no process for funding these reports in subsequent years, if progress reports continue to be needed.

The 2006-07 budget authorized FCMAT to utilize any unexpended funds available from prior years to fund additional annual written progress reports for the Oakland Unified School District, the West Fresno Elementary School District and the Vallejo Unified School District. Additional unexpended funds from this source were not available for this purpose in 2007-08. Instead, the 2007-08 budget appropriated \$385,000 in one-time Proposition 98 funds for these annual studies, including \$150,000 for Oakland Unified; \$125,000 for Vallejo Unified; and \$110,000 for West Fresno Unified.

Legislative Review of Qualifying Districts. Statute added by AB 1200 (Chapter 1213; Statutes of 1991) states intent that the legislative budget subcommittees annually conduct a review of each qualifying school district. Specifically, Education Code 41326 (i) states the following:

It is the intent of the Legislature that the legislative budget subcommittees, annually conduct a review of each qualifying school district that includes an evaluation of the financial condition of the district, the impact of the recovery plans upon the district's educational program, and the efforts made by the state-appointed administrator to obtain input from the community and the governing board of the district.

COMMENTS/RECOMMENDATIONS:

Number of Negative & Qualified LEAs Likely to Increase at Second Interim Report. The First Interim Fiscal Reports were prepared by local educational agencies prior to the release of the Governor's budget proposal for 2007-08. According to FCMAT, the number of school districts with negative and qualified certifications will increase when the Second Interim Report for 2007-08 is released by CDE in June or July to reflect assumptions in the Governor's budget.

FCMAT Budget Subject to Governor's Proposed Across-the-Board Reductions. The Governor proposes to reduce the FCMAT budget by \$88,000 on a year-to-year basis, bringing total funding to \$10.9 million in 2008-09.

Questions:

- 1. Has FCMAT been able to assess the fiscal impact of the Governor's proposed nearly \$1 billion reduction for K-12 schools in 2008-09? To what extent will the Governor's proposal affect the ability of LEAs to file fiscal reports with a positive certification?*
- 2. In considering funding flexibility options, what recommendations do you have about reducing local reserves for economic uncertainty? If this proposal were pursued, should LEAs on the negative or qualified lists be specifically excluded?*
- 3. July revenue limit apportionment payments will be deferred from July to September in 2008-09, as a part of current year savings proposals enacted in the recent Special Session for K-12 education. Will the deferral of these payments affect the fiscal status of LEAs?*

ATTACHMENT A

First Interim Status Report, 2007-08

<http://www.cde.ca.gov/fg/fi/ir/first0708.asp>

ATTACHMENT B

State Emergency Loans 1991-2007

<http://www.cde.ca.gov/fg/fi/ir/loanlist.asp>